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Take seriously his ideas about interest rates, Fed independence, and having the reserve currency.

Trump's Monetary Policy Desires Aren't Crazy

By John H. Cochrane

The policy world is aghast, but President Trump's desires for monetary affairs aren't as crazy as conventional wisdom portrays.

I see three broad desires: Interest rates should be lower, in part to lower interest costs on the debt. The Federal Reserve should be less independent, subject to more democratic accountability. And "exorbitant privilege" or "reserve currency status"—that the world wants to hold our money and buy our debt, sending us goods in return—damages the U.S.

The standard response: Lower interest rates will quickly lead to more inflation. But how soon, and how much? The best empirical estimates find that lower interest rates lead to no or slightly lower inflation for a year or so, then slightly higher inflation after two or three years. Even that response is barely significant statistically. And since the unexpected interest rate hikes these estimates study typically fade within a year or so, they say little about persistently lower interest rates.

Mainstream, or "new Keynesian," economic theory predicts that a permanently lower interest rate will eventually lower inflation, other things (especially fiscal policy) held constant, even though inflation may temporarily rise. This is an unsettling implication that the theory's largely center-left practitioners have trouble applying to reality, but there it is. Sure, maybe decades of consensus theory is all wrong. Economists have pursued wrong theories before. But if it's in the equations of your own models, the proposition at least bears consideration.

The historical record is also mixed. That inflation went nowhere over a decade of near-zero interest rates, and three decades in Japan, seems to confirm this theoretical view that inflation is stable with a fixed interest rate—and that inflation will eventually follow higher or lower interest rates. Yes, low interest rates that financed large deficits contributed to inflation in many countries. But if a government doesn't expand fiscal policy, the record is less clear. Yes, low interest rates in response to "supply" shocks, such as in the 1970s and 2020s, coincided with inflation. But the exact effect of low rates, and of other fiscal and nonfiscal responses, is also murky.

We economists don't know with certainty just if, how, under what circumstances or how quickly low interest rates lead to inflation. I suspect they do, despite the equations of my models, but that's far from science.

The Fed has vastly expanded its scope of operations, propping up asset prices, monetizing debt, channeling credit, directing banks how to invest, straying into climate and inequality, and denying whole business models such as narrow banks and segregated accounts. These actions are political and cross over into fiscal policy and credit allocation. It has had no reckoning with its great institutional failures, including 10% inflation and repeated bailouts.

Independence isn't an absolute virtue. Our constitutional order doesn't include completely independent officials who can print money and regulate banks as they wish. It is reasonable to discuss reform. Either the Fed must be more "democratically accountable," which is the same thing as "politically influenced" when the other party is in power, or it must be reformed to a narrow, enforced and accountable mandate so it can remain independent. As a small-government advocate, I favor the latter. But limited-government reforms are out of fashion and perhaps unrealistic. In any case, simply pulling up the drawbridge, hoisting the "independence" flag, and pouring boiling scorn on the barbarians at the gate isn't a viable response.

In the consensus view, if the world wants our money and debt so much that we can just print it, send it abroad, and get consumer goods in return, the proper answer is a nice thank-you note. But one must admit this strategy has had downsides. Spain and Portugal minted the world's money when they found gold and silver in the Americas and used it

to buy consumer goods. Their industries languished and then ended up poor. Money is a form of the “resource curse” that befalls many producers of oil and other vital commodities. Switzerland refuses the world’s offer and remains productive.

Even neomercantilists have a little point buried in a heap of fallacies. Countries that run perpetual trade deficits to finance consumption, borrowing abroad to do so, eventually must pay back the debt. Saving and investing rather than borrowing and consuming is good for an economy as it is for a family. -Note

The central problem in our case— and in much of history—is the bounty was consumed rather than invested. That choice flows from government deficits to financial consumption, and legal, tax and regulatory barriers that make private investment less profitable. Thus tariffs, capital controls, securities taxes and industrial policy will all make matters worse. Get out of the way instead. But in all three cases, there is some merit to the basic point, worthy of examination and not immediate disdain.

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